Supreme Court, U.S.
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No. 03-

In the

Supreme Court of the United States

CITICORP VENTURE CAPITAL, LTD,
A New York Corporation,

Petitioner,

v.

COMMITTEE OF CREDITORS HOLDING UNSECURED CLAIMS, AND COMMITTEE OF CREDITORS HOLDING UNSECURED CLAIMS AS ESTATE REPRESENTATIVE OF PAPERCRAFT CORPORATION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Does the "American Rule," under which the prevailing party to a litigation ordinarily is not entitled to an award of attorneys' fees, apply to a federal bankruptcy court exercising equitable powers under 11 U.S.C. § 510(c)?

LIST OF PARTIES TO THE PROCEEDINGS

All parties appear in the caption of the case on the cover page.

RULE 29.6 STATEMENT

Pursuant to Supreme Court Rule 29.6, petitioner states that it is a wholly-owned subsidiary of Citibank N.A., which is a wholly owned subsidiary of Citicorp, which is a wholly owned subsidiary of Citigroup Holdings Company, which is a wholly owned subsidiary of Citigroup Inc., a publicly traded company. There are no publicly held companies that own ten percent (10%) or more of Petitioner's stock.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Citicorp Venture Capital, Ltd. respectfully petitions this Honorable Court for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit.

OPINIONS BELOW

The opinion of the Court of Appeals for the Third Circuit dated March 19, 2003 (Appendix ["A"]-1–A-13), the decision as to which review is sought in this Court, is officially reported at 323 F.3d 228 and is unofficially reported at 41 Bankr. Ct. Dec. (LRP) 6.

The opinion of the District Court for the Western District of Pennsylvania, dated February 20, 2002 (A-15–A-56), is unreported.

The opinion of the Bankruptcy Court for the Western District of Pennsylvania dated September 21, 2000 (A-57–A-66), is reported at 253 B.R. 385.

The opinion of the Bankruptcy Court for the Western District of Pennsylvania dated April 20, 2000 (A-67–A-84), is officially reported at 247 B.R. 625 and is unofficially reported at 36 Bankr. Ct. Dec. (LRP) 7.

The opinion of the Court of Appeals for the Third Circuit dated November 24, 1998 (A-85–A-105), is officially reported at 160 F.3d 982 and is unofficially reported at 33 Bankr. Ct. Dec. (LRP) 647 and Bankr. L. Rep. (CCH) ¶77846.

The opinion of the District Court for the Western District of Pennsylvania, dated August 7, 1997 (A-107–A-133), is officially reported at 211 B.R. 813.

The opinion of the Bankruptcy Court for the Western District of Pennsylvania dated October 12, 1995 (A-135–A-163), is officially reported at 187 B.R. 486 and unofficially reported

at 27 Bankr. Ct. Dec. (LRP) 1252, Bankr. L. Rep. (CCH) ¶76826 and 34 Collier Bankr. Cas. 2d (MB) 745.

The opinion of the Bankruptcy Court for the Western District Pennsylvania dated April 24, 1994 (A-165–A-191), is officially reported at 165 B.R. 980 and unofficially reported at Bankr. L. Rep. (CCH) ¶75905.

JURISDICTION

The Bankruptcy Court had original jurisdiction of this case pursuant to 28 U.S.C. §§ 157, 1334. The District Court had appellate jurisdiction pursuant to 28 U.S.C. § 158(a). The Court of Appeals had appellate jurisdiction pursuant to 28 U.S.C. §§ 158(d), 1291.

The decision of the Court of Appeals was entered on March 19, 2003. This Court has jurisdiction under 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

Title 11, section 510(c) of the United States Code provides as follows:

§ 510. Subordination:

* * * *

(c) Notwithstanding subsections (a) and (b) of this section, after notice and a hearing, the court may —

(1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest; or

(2) order that any lien securing such a subordinated claim be transferred to the estate.

STATEMENT OF THE CASE

1. Parties

Petitioner was a large shareholder of Papercraft Corporation ("Papercraft"). (A-137). In March 1991, Papercraft filed a Chapter 11 bankruptcy petition in the Bankruptcy Court for the Western District of Pennsylvania. (A-138). Respondent is the Committee Of Creditors Holding Unsecured Claims and the Committee of Creditors Holding Unsecured Claims, as Estate Representative of Papercraft Corporation. (A-136).

2. Basis of the Petition

By way of background, the Bankruptcy Court below subordinated Petitioner's claim by, *inter alia*, the amount of Respondent's legal fees incurred in prosecuting an equitable subordination proceeding, as well as fees incurred in a separate proceeding brought by Petitioner to enforce its rights pursuant to the Plan of Reorganization in the underlying bankruptcy case. In both instances, the Bankruptcy Court ruled that litigation fees could be properly charged against Petitioner on the ground that, had Petitioner not acted inequitably, Respondent would have had no need to sue and incur litigation expenses. The court asserted that because it was not actually rendering an award of attorneys fees, but, rather, was merely subordinating Petitioner's claim in the amount of Respondent's litigation fees, the American Rule did not apply. The District Court affirmed. On appeal, the Third Circuit adopted the same reasoning, concluding that the American Rule did not apply to a court exercising its equitable powers. "[T]he Bankruptcy Court analyzed the record facts, found specific damages, and used its equitable powers to return the [Respondent] to the position [it] would have been in had [Petitioner] not acted inequitably." (A-9).

3. Initial Proceedings in the Bankruptcy Court

One of Petitioner's officers served on Papercraft's Board of Directors during the relevant times. After Papercraft's bankruptcy filing, from April to August 1991, Petitioner purchased approximately 40 percent of Papercraft notes from various creditors in private transactions, thereby becoming one of Papercraft's largest unsecured creditors. (A-139). On October 31, 1991 Respondent brought an adversary proceeding against Petitioner. Respondent's complaint asserted a cause of action for equitable subordination of Petitioner's claims under 11 U.S.C. §510(c), charging that Petitioner had not disclosed its identity to the selling noteholders, nor did it disclose the fact of its note purchases to the Committee or Papercraft until September 1991. (A-3, A-171 & n.7).

After discovery, both sides moved for summary judgment. In April 1994, the Bankruptcy Court ruled on those motions, but later vacated that judgment at the request of both parties. (A-191, A-163). The Bankruptcy Court subsequently held a two-day trial in November 1994. Approximately one year later, the Bankruptcy Court issued a decision finding that Petitioner breached its fiduciary duty in purchasing Papercraft notes without disclosing its identity and in failing to notify Respondent or Papercraft prior to making the purchases. *In re Papercraft*, 187 B. R. 486 (W.D. Pa. Bankr. 1995). (A-144). Rather than subordinating Petitioner's unsecured claim, however, the Bankruptcy Court created a new "*per se*" rule regulating note purchases by fiduciaries of a debtor. (A-159–A-162). The Bankruptcy Court's rule limited Petitioner's allowed claim to the amount it paid for the Papercraft notes. (A-162). In light of its newly-created rule, the Bankruptcy Court saw no need to equitably subordinate Petitioner's claims. (A-161–A-162). The Bankruptcy Court found that "there was insufficient evidence to establish that Petitioner

intended to harm Debtor or defraud its creditors, despite the result" and "no evidence that [Petitioner] engaged in conduct designed to delay the plan process." (A-159, A-161).

4. The First Appeal

On appeal, the District Court rejected the Bankruptcy Court's "*per se*" rule but held that Petitioner's claims should be subordinated because Petitioner had acted inequitably. *In re Papercraft*, 211 B.R. 813 (W.D. Pa. 1997). (A-126–A-127). The District Court held that "a fiduciary is not entitled to any profits resulting from the purchase of claims against an insolvent debtor." (A-132). The District Court authorized further subordination, but only if supported by factual findings and consistent with the principles of equitable subordination. (A-133).

Respondent appealed the District Court judgment to the United States Court of Appeals for the Third Circuit; Petitioner cross-appealed. The Court of Appeals affirmed the District Court, holding that the remedy of equitable subordination should deprive Petitioner of any profit from the note purchases and that other subordination might be appropriate if supported by findings justifying the remedy chosen by reference to equitable principles. *Citicorp Venture Capital, Ltd. v. Committee of Creditors*, 160 F.3d 982, 991 (3d Cir. 1998). (A-102–A-103).

5. The Bankruptcy Court's Orders on Remand

On remand, the Bankruptcy Court entered an interim order on April 20, 2000, holding that Petitioner's claim should be subordinated so as to remove any profit and to compensate the Respondent for any economic harm stemming from the delay in confirmation of the plan and the costs of prosecuting the adversary proceeding. *In re Papercraft*, 247 B.R. 625, 633 (W.D. Pa. Bankr. 2000). (A-82). The Bankruptcy Court found that, although Petitioner did not intend to delay the bankruptcy process in order to harm Respondent, Petitioner's

actions caused a delay in the plan process from the filing of the petition to confirmation of a plan of re-organization. (A-73). The court expressed its intention to subordinate Petitioner's claim in the amount of all fees and expenses that the Respondent claimed were incurred by Papercraft during that delay. (A-72–A-73). The Bankruptcy Court then invited further briefing. (A-79).

The Bankruptcy Court entered a final order on September 21, 2000 subordinating Petitioner's claim. *In re Papercraft*, 253 B.R. 385 (Bankr. W.D. Pa. 2000). (A-65–A-66). The Bankruptcy Court reduced Petitioner's claim to exclude any profit that might have been made; the court then ordered additional subordination of Petitioner's claim, including subordination in the amount of $2,974,373.15, calculated as Respondent's attorneys' fees associated with the entire adversary proceeding as well as a separate proceeding. (A-65).

In subordinating Petitioner's claim in the amount of Respondent's attorneys fees, the Bankruptcy Court reasoned that Petitioner's "conduct caused the amount available to the estate to pay [Respondent] to be reduced. To assure the [Respondent] the distribution [it] would have received but for [Petitioner's] conduct" the Bankruptcy Court subordinated Petitioner's claim in the amount of attorneys fees requested by Respondent. (A-65).

Petitioner appealed to the District Court.

6. The Second Appeal

The District Court upheld the Bankruptcy Court's order with one exception not material here. (A-34–A-36). In particular, the District Court held that the American Rule did not apply to the circumstances before it and that the Bankruptcy Court was not under any obligation to determine whether the fees claimed by the Respondent were reasonable. (A-23–A-24). Petitioner appealed to the Court of Appeals for the Third Circuit; Respondent cross-appealed. (A-2).

Petitioner argued to the Third Circuit that subordination in the amount of Respondent's attorneys fees was unprecedented, and had been awarded in violation of the American Rule and principles of equitable subordination. Petitioner noted that subordination in the amount of Respondent's attorneys fees did not come under any recognized exception to the American Rule. Specifically, Petitioner noted that there was no contractual or statutory basis for attorneys fees, nor had any common fund been created, nor had there been any finding — or even a request for a finding — by the Bankruptcy Court of improper conduct in the course of the litigation.

The Third Circuit affirmed the District Court in all respects. (A-13). In addition, the Court of Appeals engaged in additional fact findings beyond that of the Bankruptcy Court. Specifically, at oral argument, the Third Circuit invited Respondent to supplement its briefing with citations to the record that Respondent believed would support a claim of improper litigation tactics by Petitioner. Respondent provided such references, despite the fact that it had not moved for an award of fees based on improper conduct at any time during the long course of the litigation. Petitioner submitted a response to Respondent's post-argument submission. The Third Circuit then ruled that certain events occurring during the course of the adversary proceeding constituted "inequitable conduct" justifying subordination in the amount of Respondent's entire fees incurred since the action began in 1991. (A-10–A-11).

REASONS FOR GRANTING THE WRIT

THE DECISION BELOW CREATES AN UNPRECEDENTED EXCEPTION TO THE "AMERICAN RULE" IN CONFLICT WITH PRIOR DECISIONS OF THIS COURT AND OTHER COURTS OF APPEALS

1. Introduction

The Third Circuit's ruling flatly rejects accepted principles of the American Rule and of equitable subordination under 11 U.S.C. §510(c), categorically stating, "[w]e hold that because the Bankruptcy Court subordinated attorneys' fees pursuant to its equitable powers, the American Rule is not implicated." (A-8). In so doing, the Third Circuit carved out a massive new exception to the American Rule, not only in bankruptcy cases involving equitable subordination — themselves a fertile field of federal litigation — but in all cases in which a federal court exercises equitable jurisdiction. Indeed, this exception to the American Rule is not only literally unprecedented, but, if left unchecked, threatens to swallow the entire rule; given the merger of law and equity, every federal court has authority to exercise "equitable powers" in every civil case. *See* Fed. R. Civ. P. 1.

2. The Decision Below Disregards Controlling Decisions of this Court

The "American Rule" provides that, absent statutory or contractual authorization, or certain narrow exceptions not applicable here, parties to a litigation are "required to bear their own attorney's fees — the prevailing party is not entitled to collect from the loser." *Buckhannon Board & Care Home v. West Virginia Dep't. of Health,* 532 U.S. 598, 602 (2001) (citing *Alyeska Pipeline Service Co. v. Wilderness Society,* 421 U.S. 240, 247 (1975)). *Accord, Key Tronic Corp. v. United States,* 511 U.S. 809, 814-15 (1994); *Runyon v. McCrary,* 427 U.S. 160, 185 (1976).

The American Rule is "deeply rooted in our history and in congressional policy." *Alyeska,* 421 U.S. at 371. It was announced by this Court more than 200 years ago. *Arcambel v. Wiseman,* 3 U.S. (3 Dall.) 306 (1796). Noting that one might reasonably characterize litigation fees as a damage suffered by the prevailing party, this Court explained that "[t]he general practice of the United States is in opposition to it; and even if that practice were not strictly correct in principle, it is entitled to the respect of the court, till it is changed, or modified, by statute." *Id.* In the intervening years, this Court "has consistently adhered to that early holding." *Alyeska,* 421 U.S. at 250 (collecting cases). Indeed, the Court has repeatedly held that new exceptions to the rule should be recognized only where Congress has explicitly so directed. *E.g., Key Tronic,* 511 U.S. at 814-15; *Runyon,* 427 U.S. at 185; *Alyeska,* 421 U.S. at 263-64. Congress, obviously, has not seen fit to enact the sweeping exception promulgated by the Third Circuit in this case.

The basic flaw in the Third Circuit's reasoning is that, under the American Rule, compensation does *not* include the costs of litigation, even though such costs obviously are incurred only because of the losing party's actions. *See, e.g., Arcambel,* 3 U.S. at 306; *Zapatos Hermanos Sucesores v. Hearthside Baking Co.,* 313 F.3d 385, 388-89 (7th Cir. 2002) (Posner, J.) (American Rule precludes award of attorney's fees under provision of Convention on Contracts for the International Sale of Goods permitting recovery of "losses"); *Straub v. Veisman & Co.,* 540 F.2d 591, 599 (3d Cir. 1976) (award of attorneys' fees not permitted under provision of the Securities Exchange Act authorizing award of "actual damages"). The American Rule precludes consideration of litigation expenses as damages, even though such an award might fully compensate the prevailing party, because to do so might deter "the commencement of a lawsuit or the

assertion of a defense that might have some merit." 10 C.A. Wright, A.R. Miller & M.K. Kane, Federal Practice and Procedure: Civil 3d § 2665 at 202 (1998).

3. The Decision Below Contradicts the Holdings of Other Courts of Appeals

The Third Circuit cited no precedent supporting the proposition that the American Rule is not binding on a bankruptcy court sitting in equity. This is not surprising, because every other federal court to have addressed this issue has held, contrary to the opinion below, that the American Rule is fully applicable to bankruptcy courts. *E.g., In re Sokolowski,* 205 F.3d 532, 535 (2d Cir. 2000); *Fabian v. Western Farm Credit Bank,* 951 F.2d 1149, 1153 (9th Cir. 1991); *Shahid v. Riaz,* 254 B.R. 40, 43 (B.A.P. 6th Cir. 2000); *Agassi v. Planet Hollywood International,* 269 B.R. 543, 552 (D. Del. 2001).

4. The Decision Below Misconstrues the Power of a Federal Court Exercising Equity Jurisdiction.

That a court is sitting "in equity" does not mean that it is free to disregard well-settled principles of law; "the equity chancellor never did, and does not now, exercise unrestricted power to contradict statutory or common law when he feels a fairer result may be obtained by application of a different rule." *United States v. Noland,* 517 U.S. 535, 543 (1996) (citation omitted); *see also Reno v. Bossier Parish School Board,* 520 U.S. 471, 485 (1997) ("it is well established that courts of equity can no more disregard statutory and constitutional requirements and provisions than can courts of law") (citation and internal quotations omitted).

The general principle that a court must follow established legal principles, even when sitting in equity, has repeatedly been applied to bankruptcy courts. Indeed, this is essential to the operation of the bankruptcy system; the entire process of allowance and disallowance of claims in bankruptcy is an equitable one. *See Granfinanciera, S.A. v. Nordberg,* 492

U.S. 33, 57-58 (1989) and authorities there cited. The bankruptcy process could not function if bankruptcy courts were free to ignore settled rules in the interests of "equity."

Accordingly, as this Court has held, a bankruptcy court, "although it is a court of equity," is not free to ignore settled law "merely because the court perceives that the result is inequitable." *Noland,* 517 U.S. at 539 (citation omitted). In Circuit Judge Easterbrook's words, the phrase "'a bankruptcy court is a court of equity' is not a mantra that makes the Bankruptcy Code dissolve." *In re Milwaukee Cheese Wisconsin, Inc.,* 112 F.3d 845, 848 (7th Cir. 1997).

5. The Decision Below Distorts the Principles of Equitable Subordination

The Bankruptcy Court in this case was applying the doctrine of equitable subordination, a doctrine, originally judge-made and now codified in 11 U.S.C. § 510(c), permitting a court to give a lower priority to claims of creditors found to have acted inequitably. *See generally Noland,* 517 U.S. at 538-39 and authorities there cited. As this Court has held, however, a bankruptcy court must apply the doctrine of equitable subordination consistently with "existing doctrine," *id.* at 539, and with Congressional directions, *id.* at 540-43.

Perhaps the strongest argument against the Third Circuit's holding is the fact that in the history of American bankruptcy jurisprudence, no court has subordinated a bankruptcy claim in the amount of the adverse party's legal fees. The Third Circuit cites no such support in its opinion. So far as our research reveals, such relief was explicitly considered only once before, and rejected. *In re 641 Associates,* 140 B.R. 619, 627 (Bankr. E.D. Pa. 1992). But if the rationale of the court below — that the amount subordinated must be sufficient to compensate the bankruptcy estate for the misconduct of a creditor — then it is hard to imagine a case of equitable subordination that would not include attorneys' fees.

Neither the wording of 11 U.S.C. §510(c) nor its history indicate any Congressional intent that §510(c) serve as a vehicle for circumventing the American Rule. As this Court stated in *Noland*, "the reference in §510(c) to 'principles of equitable subordination' clearly indicates congressional intent at least to start with existing doctrine." *Noland*, 517 U.S. at 539. At the time of Congress's revision of the Bankruptcy Code in 1978, and through the date of the Third Circuit's decision, there was no judicial expression of a doctrine supporting removal of an equitable subordination action from the purview of the American Rule. Nor is there any basis for reading such intent into the statute. Again *Noland* is instructive, explaining that "[t]he normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. The Court has followed this rule with particular care in construing the scope of bankruptcy codifications." *Id.* (citations omitted). There is no evidence of any intent that §510(c) be interpreted to exclude equitable subordination from the American Rule.

The Third Circuit's decision recognizes that §510(c) calls for application of principles of equitable subordination, and that "the legislative history states that Congress intended that the courts develop these principles." *Citicorp Venture Capital, Ltd. v. Committee of Creditors*, 323 F.3d 228, 233 (3d Cir. 2003) (A-7). This observation, however, does not justify a claim that legislative intent supports the Third Circuit's ruling. The present issue — dissociation of the American Rule from actions brought pursuant to §510(c) — is not merely a judicial "development" of the law of equitable subordination. Rather, it is fundamental change from existing equitable subordination doctrine both before and after the 1978 revisions. More to the point, the ruling, if left standing, would constitute an enormous departure in the understanding of the American Rule. It is difficult to believe that had Congress any such intent it would have remained silent on the issue.

This difficulty is compounded by the fact that apparently no other case brought under §510(c) has ever reached, or even hinted at, the conclusion reached by the Third Circuit.

6. The Decision Below Improperly Usurps Congressional Power to Legislate

Finally, it must be noted that Congress has explicitly permitted the award of attorneys fees to prevailing parties under other provisions of the Bankruptcy Code. *See, e.g.,* 11 U.S.C. §§ 303(i)(1)(B) (debtor who obtains dismissal of involuntary bankruptcy petition); 523(d) (consumer debtor successful in opposing nondischargeable claim). It is for Congress, not the courts, "to pick and choose among its statutes and to allow attorneys fees under some but not others." *Alyeska Pipeline Service Co.*, 421 U.S. at 263. Congress having chosen not to allow an award of attorney's fees to a prevailing party under 11 U.S.C. § 510(c), the court below should not have done so. Its decision is contrary to prior holdings of this Court; conflicts with the decisions of other federal courts; and sets a novel and unjustifiable precedent for all federal bankruptcy litigation.

CONCLUSION

The Petition for a Writ of Certiorari should be granted.

Dated: June 16, 2003

Respectfully submitted,

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